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TAGS: ECON EINV ENRG EPET BL
SUBJECT: GAS "NATIONALIZATION" -- MORE POLITICAL SHOW THAN ECONOMIC REALITY

Summary

¶1. Despite President Morales' claim that hydrocarbons "nationalization" will bring in billions of dollars of additional income for the state, in fact, the Morales administration's actions will not significantly impact future GOB revenues. Although "nationalization" will not boost GOB hydrocarbons revenues by billions of dollars as publicly claimed by the government, it has certainly been a political victory, with President Morales' approval ratings spiking to 81 percent following the issuance of the nationalization decree in May 2006. The GOB's bungled implementation of the nationalization decree and the new operating contracts has somewhat tarnished the government's image in 2007, but nationalization remains exceedingly popular. End summary.

The Impact of the Nationalization Decree

¶2. Despite President Morales' claim that hydrocarbons "nationalization" is his administration's greatest accomplishment, "nationalization" basically implemented the 2005 law passed by former President Carlos Mesa during his administration, generating very modest additional revenue. According to our estimates, Morales' nationalization decree boosted government revenue by some USD 224 million in 2006 (largely as the result of a transitory 32 percent tax on two large petroleum fields), and it will not materially increase revenue in out years. Only Petrobras was significantly impacted by the fee, as it operates the two large fields affected by the transitory tax.

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So Why the Large Increases in Revenue in 2006?
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¶3. GOB revenue from the hydrocarbons sector amounted to USD 409 million in 2004, USD 863 million in 2005, USD 1.5 billion in 2006, and a projected USD 1.3 billion in 2007. The increases in GOB revenue resulted from three main factors: increases in the price of gas sales (sales to Brazil increased from USD 2.15 per million cubic feet in 2004 to USD 3.80 per million cubic feet in 2006), increases in the volume of production (gas production increased from 35 million cubic meters per day in 2004 to 41 million cubic meters per day in 2006), and the implementation of the direct hydrocarbons tax by the 2005 law passed by former President Carlos Mesa (the companies paid USD 695 million in IDH in 2006). Only USD 224 million of the 2006 revenue resulted from the Morales administration's "nationalization" decree, which imposed a temporary 32 percent tax on the large fields operated by the Brazilian company Petrobras. Once the new operating contracts enter into force, presumably in 2007, this temporary tax will disappear.

The Impact of the New Contracts

¶4. International gas production companies operating in Bolivia signed new contracts in October 2006. The government erroneously claimed that the new 23 to 30 year contracts would yield billions of dollars in additional revenue for the state. The contracts were approved by congress in November ¶2006. Subsequently, the GOB realized that the versions of the contracts approved by congress were incorrect, because the state oil company YPFB had provided congress with the

wrong documents. Many of the approving laws contained typographical and substantive errors. The GOB proposed a short law to amend superficial errors, which was approved by the lower house and blocked in the senate. The senate held hearings the weeks of March 19 and 26 to decipher the confusion, including why YPFB supposedly signed two versions of a particular annex with Petrobras. Opposition leaders, and far-left members of the MAS, have asserted bad faith on the part of the GOB. On March 30, the senate approved 41 production contracts, while debate continued regarding the remaining three.

¶5. The GOB's main accomplishments with the signing of the new contracts were convincing the companies to drop their pending legal claims against the 2005 law and solidifying the law's mandates of contract migration and paying the 32 percent direct hydrocarbons tax (IDH). Although, in addition to requiring companies to pay the pre-existing taxes and royalties, the contracts imposed another variable tax to be paid to YPFB, they also allowed companies to deduct certain general taxes. Based on GOB revenue predictions, it seems that in 2007, the increased costs of the YPFB tax, perhaps less than USD 100 million, may be roughly offset by the deduction of certain general taxes, including the value added tax. According to Petrobras, some fields will even be paying less to the GOB under the new contracts than they were paying previously. Under Petrobras' prior contract, including the 32 percent IDH which it was paying under protest, Petrobras paid the government around 60 percent of the value of its production. Under its new contract, it will pay around 54 percent in 2007, but that percentage will increase to around 61 percent by 2010.

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The Impact of the Argentine Gas Sales Agreement
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¶6. With the signing of a gas sales contract with Argentina in October 2006, the GOB opened up the possibility of expanding Bolivia's gas production by 50 percent. The possibility of supplying this additional market encouraged the companies to agree to sign new contracts. The ability to meet the terms of this agreement will depend on the construction of a USD

1.5 billion pipeline, almost all in Argentina, and private companies' willingness to invest in production and exploration in Bolivia. Given the ongoing legal uncertainty, such investment has not yet been forthcoming. If the investment eventually pans out, the significant increase in production would mean a significant increase in GOB revenues. If production increases by 50 percent by 2010, as required by the contract, the GOB predicts that revenue will reach USD 2.4 billion by 2010, a 60 percent increase over 2006. However, given the current lack of investment, reaching these production figures within three years will be near impossible.

The Lost Bonanza?

¶7. It is difficult to predict what would have happened to sector investment if the gas wars, the 2005 law, the nationalization decree, and the new contracts had never happened. However, it is certain that foreign direct investment in the sector has declined to the minimum necessary to meet contractual obligations, amounting to USD 197 million during 2006 compared with the 1998 peak of USD 600 million. According to Petrobras' explanation of typical gas investment cycles, Bolivia should have received another large wave of investments, similar to what occurred in 1998, around 2004. However, investment hit rock-bottom in 2005 and

remained there during 2006 due to the ongoing legal uncertainty and GOB plans to increase state intervention in the sector. The companies were hopeful after the signing of the new contracts that they could finally make long-term plans, but because of the GOB's failure to send correct documents to the congress for approval, the uncertainty has continued. Without increased investment, gas reserves will continue to decline. Current production, already at its maximum, is insufficient to meet Bolivia's contractual obligations with Brazil and Argentina and domestic demand. Without additional investment, Bolivia could be forced to pay contract penalties. Additionally, Bolivia has likely lost the opportunity to supply a greater share of the Brazilian market than it currently does, because Brazil is looking for alternatives to reduce reliance on Bolivian gas.

The Political Fallout

¶8. The GOB's nationalization decree and the signing of new contracts boosted the administration's popularity, as around 85 percent of the population supports "nationalization." However, the congressional hearings regarding YPFB's negotiation of the contracts, GOB errors, and possible secret negotiations by former YPFB adviser Manual Morales Olivera with Petrobras, have somewhat tarnished the government's image. (Note: In response to the scandal, the GOB replaced Manuel Morales as YPFB president with Guillermo Aruquipa on March 23. End note.) The failure to revamp the state oil company YPFB, to negotiate the take-over of five key companies, and to secure additional investment in the sector has also reflected poorly on the GOB. Recent polls show that 52 percent of the residents in La Paz, typically a region of strong support for the Morales administration, disapprove of the GOB's handling of the gas contracts. (Note: This has not affected President Morales' popularity, however. A March poll put his approval rate at 65 percent, the same level as in the month of February. End note.)

Conclusion

¶9. After the GOB signed new operation contracts with natural gas production companies in October 2006, the press announced that the four largest gas fields would have to pay an additional 32 percent tax to state-owned oil company YPFB. The assertion regarding the large fields was not true, but it

led the public to believe that the contracts would immediately yield an enormous windfall for the country. In fact, the new operating contracts will not significantly impact GOB revenue in comparison with what it would have been under the terms of the old contracts plus the direct hydrocarbons tax imposed by the 2005 law. Some fields will even be paying less under the new contracts than they were before, although the government take will increase over time. The instability which began in 2002 and has been perpetuated by the Morales administration has cost the country hydrocarbons investment and market opportunities, which would have broadened the tax base. It remains to be seen if the sector's decline can be turned around and the promise of the Argentine market fulfilled, but short-term prospects are negative. In sum, the GOB's revenue gains from the nationalization decree and new contracts appear to be marginal compared with the potential loss of investment due to the "nationalization's" damage to the investment climate. End comment.
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